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May 23, 1995

EX PARTE OR LATE FILED

BY HAND DELIVERY

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Room 222
Washington, D.C. 20554

RECEIVED
MAY 23 '95
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Re: Ex Parte Presentation in CC Docket No. 92-264, Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992: Horizontal and Vertical Ownership Limits

Dear Mr. Caton:

Pursuant to Section 1.1206(a) of the Commission's rules, this is to report that the undersigned met with Mr. Ronald Parver on May 23, 1995, concerning the above-referenced proceeding. At the meeting, Mr. Ellrod discussed the attached document and franchising authorities' views of the anti-trafficking provisions of the Cable Television Consumer Protection and Competition Act of 1992 and related Commission rules.

An original plus one copy of this letter, with copies of the attached document, is being furnished for inclusion in the record of CC Docket No. 92-264.

Very truly yours,

MILLER, CANFIELD, PADDOCK AND STONE

By Frederick E. Ellrod III
Frederick E. Ellrod III

Enclosure
cc: Mr. Ronald Parver

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CABLE TELEVISION FRANCHISE TRANSFERS: FEDERAL, STATE AND LOCAL REGULATION

I. INTRODUCTION AND SUMMARY

During the mid- to late 1980's, there was a very active market in the buying and selling of cable systems, giving rise to a host of transfers of cable system franchises. During this period, cable franchise transfers were governed almost exclusively by state and local law. The Cable Communications Policy Act of 1984 ("1984 Cable Act"), which was the first federal statute to deal comprehensively with cable systems, did not address franchise transfers. Indeed, other than general FCC transfer approval authority over radio licenses (which applies to CARS and any other FCC radio licenses held by cable operators), there were virtually no federal communications laws or regulations concerning transfers of cable systems or control of cable system ownership.

That changed in 1992. The Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act") significantly amended the 1984 Cable Act, introducing for the first time federal statutory provisions addressing transfers of cable system ownership or control. Most of these provisions are found in the new Section 617 of the Communications Act, codified at 47 U.S.C. § 537. A few are also found in amendments to the cable cross-ownership restrictions of Section 613, 47 U.S.C. § 533. As required by the 1992 Cable Act, the FCC subsequently adopted rules implementing these statutory provisions in <u>Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations and Anti-Trafficking Provisions</u>, MM Docket No. 92-264, Report and Order and Further Notice of Proposed Rulemaking, FCC 93-322 (released July 23, 1993) ("<u>FCC Order</u>").

Stated briefly, the 1992 Cable Act changed federal law governing cable system transfers in four ways. The Act:

1. generally prohibits transfers of cable systems within three years of system acquisition or initial construction, subject to certain

exemptions and a waiver provision (the so-called "anti-trafficking" restriction);

2. imposes new cross-ownership prohibitions, generally barring common ownership of cable systems and MMDS providers or SMATV systems in those parts of a cable system's franchise area served by the system;[1]

3. provides that unless a local franchising authority acts on a cable operator's franchise transfer request within 120 days after the operator provides the information required by the FCC and the franchise authority, the transfer is deemed approved; and

4. makes clear that a franchising authority may prohibit common ownership of cable systems within its jurisdiction and deny any transfer request that would eliminate or reduce cable competition in its jurisdiction.

While these new federal requirements concerning cable system transfers are significant, it is still probably the case that in most instances, consideration of local law and franchise provisions will predominate in franchise transfers. This thesis, as well as the new federal requirements, will be tested soon: a new wave of cable system transfers appears to be beginning, prompted at least in part by the industry's view that consolidation is essential to meet the perceived looming threat of telephone company entry into the market.

II. FEDERAL CABLE ACT PROVISIONS AND FCC RULES CONCERNING CABLE TRANSFERS

A. Standard Form 394.

In an attempt to expedite the franchise transfer process and to ensure that local franchising authorities receive the necessary information to conduct a thorough review of a proposed transferee's qualifications, the FCC created a standard transfer form - Form 394. The Form 394 solicits information necessary to establish the technical, legal and financial qualifications of the proposed transferee. Upon receipt of a completed Form 394, together with any additional information required by the franchise, the franchising authority has 120 days to approve or deny the transfer request.

B. Anti-Trafficking Restriction

The new Section 617(a) of the Communications Act provides that "no cable operator may sell or otherwise transfer ownership in a cable system within a 36-month period following either the acquisition or initial construction of such system by such operator." 47 U.S.C. § 537(a). Section 617(b), however, provides that in a multiple system transfer where the terms of the sale require the buyer to subsequently transfer one or more of the systems to a third party, the subsequent transfer is considered part of the initial transaction. 47 U.S.C. § 537(b). See also FCC Order at ¶ 9.

1. What Constitutes a Transfer of Ownership. The Cable Act does not define what constitutes a "transfer" of ownership of a cable system subject to the anti-trafficking provisions.

   a. The criteria for application of anti-trafficking rule is analogous to that for CARS transfers and, indeed, for FCC license transfers generally: where there is a "change in the identity of the franchisee, or in the holder of a controlling interest in the cable operator", the anti-trafficking rule will apply. FCC Order at ¶ 23.

   b. Anti-Trafficking rule does not apply to entity not a cable operator. FCC Order at ¶ 19.

   c. Issues of de facto control will be addressed on case-by-case basis. FCC Order at ¶ 26.

2. Calculation of Three Year Holding Period.

   a. Initially Constructed Systems - Holding period measured from date on which service is activated to the system's first subscriber. FCC Order at ¶ 46.

b. Acquired Systems - Holding period begins on effective date of closing of transaction in which system was previously acquired. In cases of staged or installment acquisitions, holding period begins on effective date of transaction in which previous transferee or assignee acquired control of cable system. FCC Order at ¶ 47.

c. Multi-System Operator Transfers - FCC will entertain and look favorably upon requests to waive anti-trafficking restriction in transfer of MSO where two-thirds or more of the MSO's subscribers are served by cable systems owned for three years or more. Similarly, if MSO is transferring several systems, FCC will look favorably upon request for waiver if two-thirds of subscribers served by systems to be transferred are served by systems owned for three years or more.

3. Monitoring Compliance - FCC expects franchising authorities to monitor compliance with anti-trafficking rule. FCC Order at ¶ 36.

a. Cable operators seeking to assign or transfer ownership must certify to franchising authority that (i) transfer complies with anti-trafficking rule; (ii) cable operator is seeking or has obtained waiver from FCC; or (iii) cable operator is otherwise exempt from rule. FCC Order at ¶ 37.

(1) Generally, certification is submitted simultaneously with request for approval. 47 C.F.R. §76.502(d), FCC Order at ¶ 37. If franchising authority approval of transfer not required by franchise agreement, certification must be submitted not later than 30 days prior to transfer closing date. FCC Order at ¶ 37.

(2) Operator's certification must contain complete description of transaction and nature of interest being transferred,

date interest was acquired by transferor and effective date of proposed transfer.

b. Receipt of proper certification by franchising authority creates a presumption of compliance.

(1) Franchising authority has 30 days to question accuracy of certification or the certification deemed accepted.

(2) Thirty day period not tolled by franchising authority requests for additional information unless cable operator fails to provide complete and accurate responses within 10 days of date of such request. 47 C.F.R. §76.502(d), FCC Order at ¶ 38.

4. Exceptions to Holding Period.

The three-year holding period does not apply to (i) any transfer of ownership interest in a cable system that is not subject to Federal income tax liability; (ii) any sale required by operation of any law or any act of any Federal agency, any State or political subdivision thereof, or any franchising authority; or (iii) any sale, assignment, or transfer, to one or more purchasers, assignees, or transferees controlled by, controlling, or under common control with, the seller, assignor, or transferor. 47 U.S.C. § 537(c)(1)-(3).[2] Anti-trafficking certifications claiming any exemption under §617(c) must be accompanied by an explanation of the basis for the claimed exemption. The franchising authority may request additional information. FCC Order at ¶ 64.

a. Transactions not subject to Federal Income Tax.

Congress intended to exempt all transactions qualifying as "tax exempt" under the Code. This includes all transactions in which there is no cognizable gain or there is a loss, as well as transactions in which recognition of taxable gain is deferred. FCC Order at ¶ 63, n. 51.

b. Transfers required by law.

Includes involuntary transfers to effect bankruptcy, divorce or probate proceedings. Also includes transfers involving municipally-owned cable systems. FCC Order at ¶¶ 67-68.

c. Intracorporate transfers.

(1) Applies to all pro forma transfers as defined in 47 C.F.R. §73.3540(f).

(2) "Common control" as used in §617(c) includes transfers between affiliated entities, regardless of whether such affiliation by virtue of common stock ownership, other equity or debt ownership, or management control. FCC Order at ¶ 72, H.R. Rep. No. 102-628, 102d Cong., 2d Sess. (1992) ("House Report") at 119.

5. Waivers.

a. Section 617(d), 47 U.S.C. § 537(d), governs waivers of the anti-trafficking provisions. The FCC has broad discretion to grant waivers in the public interest. FCC Order at ¶ 78. Waivers are also required to be granted in cases of default, foreclosure or other financial distress.

(1) Default - Waiver applicants must make affirmative factual showing, supported by affidavits of a person or persons having personal knowledge that the cable operator is in default, other than a technical default, under the terms of a credit or loan agreement pursuant to which the cable operator is primarily liable. Copies of default notices or

other documentation should be submitted. FCC Order at ¶ 79.

(2) Foreclosure - Waiver applicants must make affirmative factual showing, supported by affidavits, that a foreclosure action has been initiated with respect to property affecting the ability of the cable operator to maintain cable services. Copies of foreclosure notices or other documentation should be submitted. FCC Order at ¶ 79.

(3) Financial Distress - Waiver applicants must make affirmative factual showing, supported by affidavits, of existence of financial distress. Evidence of operating loss or insufficient capital to maintain operations are indicia of financial distress. FCC Order at ¶ 79.

b. Blanket waiver for small systems serving 1000 subscribers or less. FCC Order at ¶ 3.

c. If approval of the franchising authority is required, FCC may grant a conditional waiver subject to the ultimate approval of the transfer by the franchising authority. FCC Order at ¶ 78.

6. Anti-Trafficking Dispute Resolution.

Franchising authorities to notify FCC of willful violation of anti-trafficking rule. FCC will determine appropriate sanctions. FCC Order at ¶ 40.

C. 120 Day Limitation on Franchise Authority Consideration of Transfer Requests

1. Section 617(e) of the Cable Act provides that a franchising authority has 120 days to consider transfer requests involving systems owned for 3 years or more. If the franchising authority does not act within the 120 day period, the request is deemed granted. Cable Act at §617(e). The

franchising authority and the requesting party can agree to extend this period. Cable Act at §617(e).

2. When does 120-day period begin? The 120-day period begins to run from the date the cable operator submits a transfer request on Form 394 to the franchising authority containing all information required by FCC regulations and all information required by the operator's local franchise agreement. FCC Order at ¶ 80, 47 U.S.C. § 537(e).

3. Other Conditions.

    a. Franchising authority may request additional information to permit it to determine the legal, technical and financial qualifications of the proposed transferee. Such requests do not toll the 120-day period. FCC Order at ¶ 86.

    b. Section 617(e) of Cable Act not intended to limit franchising authorities' authority to require in franchise agreements that cable operators provide additional information and guarantees in connection with a transfer. House Report at 120.

D. Ownership Restrictions

1. 47 U.S.C. § 533(d) permits a franchising authority to deny a transfer because of (i) the transferees ownership or control of another cable system within the franchising authority's jurisdiction; or (ii) the franchising authority determines that such a transfer would eliminate or reduce competition in the delivery of cable service in such jurisdiction.

2. 47 U.S.C. § 533(a)(2) prohibits a cable operator from holding a MMDS license in any portion of the franchise area served by the cable operator's cable system. However, cable operators are permitted to use one MMDS channel in a protected area to provide local programming to that area. FCC Order at ¶ 111.

3. 47 U.S.C. § 533(a)(2) prohibits a cable operator from offering SMATV service separate and apart from the franchised cable service to any portion of the franchise area actually served. FCC Order at ¶ 119. Cable operators may provide SMATV service within franchise area provided that such service is provided in accordance with all provisions of franchise. FCC Order at ¶ 124.[3]

III. STATE LAW ISSUES

A. Cable Television Law.

Some states have statutes and/or regulations governing cable television regulation and franchise transfers.

B. Contract Law.

State statutes and common law governing contractual relations are applicable to franchise agreements.

C. Tort Law.

Franchising authority's disapproval of a transfer is often challenged under a "tortious interference with contract" theory. The issues under this theory are whether (i) the franchising authority acted within its powers in the actions it took to protect its rights under the franchise; and (ii) the franchising authority followed a process reasonably related to the protection of its interests.

IV. LOCAL FRANCHISE REQUIREMENTS AND CABLE FRANCHISE TRANSFERS

A. Franchise Agreement

a. Most franchise agreements explicitly require the franchising authority's prior approval of a transfer or assignment of the franchise, or control of the franchise, to a new entity.

b. Franchising authority's right to approve of disapprove transfer may be qualified by terms of franchise agreement (e.g. approval may be required for asset sale but not for stock sale; "consent may not be unreasonably withheld").

c. Franchise may contain procedural requirements, i.e. public hearing.

B. <u>Other Issues in the Transfer Process</u>.

<u>Requests for Information</u>. If the franchise agreement requires that specific information be provided, such information must be included with the submittal of the Form 394. If the franchising agreement does not require specific information, the information required by the Form 394 is deemed sufficient.

C. <u>Relevant Issues for Local Franchising Authority Consideration</u>.

1. The financial, technical and legal qualifications of the proposed transferee.

2. Effects on local competition.

3. <u>Commitment to Comply fully with the Franchise</u>. Franchising authority should get a written commitment from proposed transferee that it will abide by all provisions of the franchise.

4. <u>Obligation Either to Cure Breaches of Transferor or for Transferee to Step into the Shoes of Transferor</u>. Should have transferee commit, in writing, to assume all of transferor's obligations and liabilities under the franchise, known and unknown.

5. <u>Other Public Interest Considerations</u>.

6. <u>Guaranty of Performance</u>.

ENDNOTES

1. The FCC recently announced that it will revise its rules to loosen further the cable/SMATV cross-ownership restriction. These changes are discussed below.

2. In an open meeting held January 12, 1995, the FCC clarified that, in connection with transactions exempt from the three-year holding period, a new holding period does not commence upon the consummation of such transaction. See FCC Report No. DC-, Commission Reconsiders First Report and Order Regarding Cable System Anti-Trafficking Rules and Satellite Master Antenna TV Cross-Ownership Limitations (MM Docket 92-264) (Released January 12, 1995) ("FCC Report").

3. On January 12, 1994, in an open meeting, the FCC announced a modification to the SMATV-cable cross-ownership rules. The modification permits a cable operator to purchase SMATV facilities in its franchise area provided the acquired SMATV facility is operated in accordance with the terms and conditions of the franchise agreement. FCC Report.

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